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BEFORE THE
Surface Transportation Board
WASHINGTON, D.C. 20423

Public Views On Major Rail Consolidations	)	**Ex Parte No. 582**

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COMMENTS
OF
THE SOCIETY OF THE PLASTICS INDUSTRY, INC.

The Society of the Plastics Industry, Inc. (SPI) respectfully submits its views to the Surface Transportation Board in response to the Board's solicitation of Public Views on Major Rail Consolidations.

I. STATEMENT OF INTEREST

SPI is the national trade association of the plastics industry, comprised of nearly 1700 members representing all industry segments in the United States. SPI's business units and committees are composed of plastics processors, raw material suppliers, machinery manufacturers, moldmakers and other industry-related groups and individuals. Founded in 1937, SPI serves as the voice of the plastics industry. SPI is the only industry association representing the entire distribution chain of the plastics industry, from the production of raw materials to the use of those raw materials for fabrication into component and end-products, and the ultimate distribution of those fabricated products to contract customers and to markets.

Plastics resins, STCC 28211, constitute some 70 billion pounds of railroad traffic, amounting to more than 350,000 carloads of traffic and in excess of $1.25 billion in freight revenue. Approximately 60% of plastics resins shipped are captive at the point of origin or destination to a single railroad, and more than 10% of additional production capacity is effectively captive due to the ability of one of the serving railroads to leverage its position based on sole service to a different plant of that same producer. Even where points of production may be open to competitive service, numerous processors, or downstream users, of plastics resins are captive to a single railroad.

The plastics industry is one of the most rail dependent industries in the country, and indeed in North America. Approximately 85% of the primary plastics resins, polyethylene and polypropylene, are transported by rail, at an average length of haul exceeding 1,000 miles. The industry owns in excess of 40,000 covered hopper cars, utilized for the transportation of plastics resins from producers to fabricators; and throughout the industry's development and growth over the past 50+ years, rail transportation has been integral in the plastics industry's supply chain.

II. COMMENTS

A. Overview

SPI applauds the Board for the action taken first in the BN/CN merger proceeding, Finance Docket No. 33842, wherein the Board advised that it would waive its regulations to examine cumulative impacts and crossover effects, and subsequently for the initiation of this proceeding entailing a broad review of rail consolidations and the agency's regulatory policies. Over the past five years alone there have been five major, Class I railroad consolidations, involving the UP/CNW, BN/SF, UP/SP, CN/IC and the acquisition and division of Conrail by CSX and NS. All but one of those transactions sent shockwaves through the shipper community, the economy of the country, and caused other longer-term effects felt by customers downstream of the plastics industry. Accordingly, before embarking upon a path which the Board has recognized "may trigger yet another full round of major transactions,"[1] it is well that the Board step back and look at all of the issues surrounding major rail consolidations and the Board's merger policies.

B. Whether Further Railroad Consolidation Would Be In The Public Interest

The Board invites the views of shippers and other members of the public on whether further railroad consolidation would "be a good thing for large and small railroads, and for their customers and employees, and, more broadly, whether it would be in the public interest."[2] SPI respectfully submits that the Board must view any further major railroad consolidation with a jaundiced eye. As alluded to above, implementation of four of the five recent rail mergers has resulted in major service disruptions. UP vigorously asserted in the UP/SP merger that it had learned from the service disruptions experienced in the UP/CNW merger and that it was effecting the planning necessary to achieve a smooth transition if allowed to acquire the Southern Pacific. Notwithstanding, UP's integration of the Southern Pacific lines produced, in the words of its own chairman, the "worst rail crisis in modern history." Similarly, CSX and NS went to great lengths in their application to acquire and divide Conrail to assure the Board and the public that they had studied the experiences of the UP/CNW, BN/SF and UP/SP mergers in order to achieve a smooth

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1 BN/CN, STB Finance Docket No. 33842, Decision No. 1 and 1A at p. 3 (Served Dec. 28, 1999).

2 Public Views on Major Rail Consolidations, Notice of Public Hearings and Request for Comments,

transition of Conrail, and they substantially delayed the implementation date after almost one year of planning during the application process for 10 months of further planning after approval was granted by the Board. Nonetheless, CSX and NS both have experienced serious degradation of service that is now entering its 10th month.

Undoubtedly, CN will point to the CN/IC merger as a transaction achieved without the service disruptions surrounding the other mergers of the past five years. They further will likely assert that a BN/CN merger is similar to the CN/IC merger in terms of being essentially end-to-end, and entailing use of similar computer platforms. First, such a claim must be placed in context – it being understood that operational changes only recently were initiated. Additionally, arguments similar to those expected from CN were made in the BN/SF merger application; and we know too well the service problems they encountered. Moreover, the Board now is looking at "cumulative impacts and crossover effects."[3] Accordingly, if, in fact, the next major rail merger, whether BN/CN or otherwise, can be anticipated to lead to subsequent mergers by other carriers, the Board must consider the prospect that future mergers will be infected with implementation problems similar to those produced in four of the last five mergers. This is particularly true since subsequent mergers will not necessarily be "end-to-end," as the BN and CN characterize their transaction. Looking at the potential marriages between eastern and western carriers, BN extends into the southeast; NS extends into the midwest, and KCS and CP serve common points and parallel routes with several of the major carriers. Given the experiences and lessons learned to

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at p. 3 (Served Jan. 24, 2000).

3 BN/CN, *supra.*

date, whatever the outcome for a smooth transition of the BN/CN, there can be no comfort that any subsequent merger which surely will happen, with the railroads seeking to consolidate into two trans-continental systems, will be achieved without further service disruptions adversely impacting the shipper community.

Looking beyond the integration problems, the Board must also consider whether the recent mergers have produced the promised benefits. Certainly, there have been cost savings achieved through elimination of railroad employees, particularly in accounting and marketing functions. Downsizing the number of employees and consolidating responsibilities is relatively easy; improving service has proven much more difficult.

Members of SPI, and customers of the railroad industry generally, have complained about a degradation of service as a consequence of rail consolidations. This occurs on two levels. First, customer service personnel have been trimmed, with increased reliance upon anonymous telephone representatives rather than customer service representatives who know both the customer and the railroad. Moreover, while intermodal customers may have seen improved transit times, manifest customers generally have not. Service today is no better, and in many cases worse, than the service rendered years and even decades ago. This point was dramatically demonstrated by a recent letter to *Traffic World* from Doug Midkiff, who has been in the transportation industry for more than 50 years.[4] Midkiff recites that "as an avid teen-age train watcher, I could count on the morning freight train passing through town just as the 7 o'clock

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4 *See* "Scheduled Service Can Work," Letter to *Traffic World*, July 19, 1999 at p. 4, appended hereto as Exhibit A.

company whistle blew." He also refers to a 5-line haul between Jersey City and Boston that, through coordination of operations, was competitive with the single-line route of the Pennsylvania Railroad north of Hagerstown. According to Midkiff, railroads formerly were competitive not only with each other but also with truck traffic. One of the principal benefits claimed by railroads going into mergers is increased efficiency by combining operations. This claim has met with dismal failure.

Before embarking upon another round of rail mergers, SPI respectfully requests that the Surface Transportation Board conduct an in-depth study of the benefits promised in the recent rail mergers of the 1990's, and compare the benefits with the actual results achieved. If the railroad industry has not delivered on its past promises of "public benefits" through improved service, there is no reason to expect that future mergers will provide this outcome.

The railroad's poor results impact not only their customers, but also their shareholders. CSX and NS paid approximately $20 billion for Conrail, 50% to shareholders and the other 50% in debt assumption and facilities improvement for the integration and transaction costs. Notwithstanding, the enterprise value of CSX, including its Conrail component, as measured by the stock price times the shares outstanding, is barely more than CSX paid the public shareholders for its share of Conrail; and the value of NS is at, or slightly below, the price which NS paid for its share of Conrail. Against this backdrop, the Chairman of CSX was recently reported to have told financial analysts, notwithstanding its representations during the Conrail acquisition that it would pay for Conrail through growth of traffic and efficiencies, that indeed it would be increasing rates paid by the shipper community.[5] Equally so, western railroads are not held in high esteem by the financial community. The principal question becomes how much more of this strategy can the shipper community and the public, at large, take? Rather than simply seeking to extend systems through acquisitions, would not the railroads and their customers be better off if the railroads undertook improving service to retain customers and regaining market share through offering quality service, thus warranting a diversion of traffic from highways to rail?

Considering the effects achieved through past mergers, the Board must entertain the question of whether cooperative arrangements, such as those described by Midkiff in his letter to *Traffic World*, can produce the same results or better, than achieved through consolidation. Coordination of schedules, run-through trains and other cooperative arrangements would appear to produce the same benefits as achieved through end-to-end mergers. Moreover, to the extent that there continues to be a choice between, or among, connecting carriers, the eastern and western carriers, rather than being locked into a single partner in other regions, can utilize the ability to place or withhold traffic thereby providing incentives to implement quality service arrangements. The loss of choice of a connecting carrier is not only a competitive consideration,[6] but also can have substantial impact upon the ability of the railroads to grow their traffic and their businesses.

5 Additionally, having abandoned or curtailed track operations, and having degraded rather than improved service, the Class I railroads now cite to capacity constraints as warranting rate increases.

C. The Board Must Reexamine Its Policies Concerning Competitive Effects Of Rail Merger

Implicit in the STB decision to initiate this proceeding, and explicit in the Board's December 28 Decision in the BN/CN merger proceeding, is the notion that the merger of Burlington Northern Santa Fe and Canadian National Railway would lead to "competitive responses" from other railroads resulting in further, and likely, final consolidation of the railroad industry.[7] This issue of parity is echoed throughout the Board's UP/SP merger proceeding. One of the dominant themes of the Board's decision in that proceeding is that the UP acquisition of the SP was justified in order to enable UP to be an effective competitor to the merged BN/SF. There was no assertion that the financial viability of the UP would be endangered without SP. In fact, in 1994, prior to the BN/SF merger, UP's net railway operating income was more than 30% greater than that of the BN, and slightly exceeded the combined net railway operating income of BN and SF together.[8] UP grew its operating income by almost 16% in 1995, while the net railway operating income of BN and SF declined by 1/3.[9] Moreover, at the time, each railroad had significant market strengths in particular commodity or regions as compared with the other, *e.g.*, UP's position as the primary carrier of plastics and chemicals originating in the Gulf Coast.

6 See discussion under Section C below.

7 CP, CSX, NS and UP confirm this expectation, *inter alia*, in their "Open Letter to Railroad Customers," published January 11, 2000 in *The Journal of Commerce* and elsewhere.

8 *Railroad Facts*, Association of American Railroads, 1994 edition.

9 *Railroad Facts*, Association of American Railroads, 1995 edition.

SPI respectfully submits that the proper role of the Board is to protect both essential services and competition, not to manage competition between and among the railroads. The Board should not be concerned whether one railroad has more miles of track or more gross income than another does. The essential question regarding a railroad's viability in the market should be whether a merger of two railroads will so financially threaten another railroad as to imperil essential transportation service, including analysis of whether, if the imperiled railroad were to fail, its essential services and its competitive position in the industry could be replaced through line acquisition by another carrier.

Rather than focusing upon managing competition within the railroad industry, SPI respectfully submits the proper role for the Board is to *protect* competition available to the shipper community. In this regard, SPI believes the Board must reevaluate the approach used in prior mergers to evaluate competition. In doing so, the Board must recognize that competition between and among railroads, where it exists, is an everyday practical experience to the railroads and their customers; it is not a matter of theoretical economics. Railroads, and their customers, live in the dynamic world of inter-state commerce and must be able to respond accordingly.

The first competitive issue for the Board to reexamine is the "one lump theory." Future mergers will have an even greater effect than prior mergers in reducing downstream competition available to shippers who may be captive at one end of the movement. This is inevitable when one contemplates the pairing off of the eastern and western railroads into two transcontinental rail systems. If allowed to occur without adequate protective conditions, the route control exercised by each of the transcontinental carriers will reshape supply chain relationships.

In prior merger proceedings, the Board (and the Interstate Commerce Commission prior to the creation of the STB) has rejected shipper evidence of downstream competition as "anecdotal," and inconsistent with an economic theory which states that a monopolist will husband all of the monopoly profits for itself in setting a rate division, leaving the downstream carriers a share of the revenue sufficient only to cover their costs plus provide a return on capital adequate to induce the downstream carrier to provide the transportation service. In the real world, no railroad is a gatekeeper at only a single point where it meets its connecting carriers and thus can erect a moat around its service territory in which it can acquire and store its "one lumps." Rather, any given railroad is a monopolist at one location, a competitor at another location, and a "friendly connection" to another bottleneck carrier at yet another location. Whatever a theoretical monopolist may do under laboratory conditions, railroads in fact must maintain friendly relations with their connections and, accordingly, do not practice "one lump" monopoly pricing. This is not a matter of acquiring "perfect pricing" information; it is a function of marketplace relationships. Accordingly, SPI respectfully urges the Board to reconsider the "one lump theory," just as the Board reconsidered and revised its policy concerning the role of product and geographic competition in rate reasonableness determinations.

Second, the Board has taken the position that the only remedial loss in rail merger proceedings is the elimination of competition, the so-called "2-to-1" situations. Reductions in competitions, from 3 carriers to 2 carriers or even 4 carriers to 3 carriers, has not been viewed as a loss warranting remedial action. Competitive policies applied by the antitrust regulatory agencies, however, consider qualitative as well as quantitative competitive effects of mergers. The third carrier available to serve a route of movement often serves to stimulate the competitive forces, both from service and price standpoints. Transportation is not unique as compared with other service and product industries; and accordingly, the Board in considering future rail mergers should consider qualitative as well as quantitative competitive effects.

Finally, SPI urges the Board to reexamine its position with regard to trackage rights as a remedial measure. Overhead trackage rights have long been used to compensate for a loss of effective route competition. In the UP/SP merger, however, extensive trackage rights were granted not only to compensate for loss of effective route competition, but also to compensate for a loss of effective competitive access, particularly for dual-served plants in the Gulf Coast. Accordingly, BN, as the tenant carrier, is dependent upon the UP lines and yards for access to many customers, particularly those in the plastics and chemicals industries in the Gulf Coast, which formerly were served by both UP and SP. When the UP experienced its service meltdown of 1997-1998, BNSF consequently was similarly adversely impacted; and many of the plants where competitive service was to be retained lost that competitive opportunity since the UP's problems affected not only its services but also that of BNSF. Should further rail mergers be permitted, competitive losses must be remedied through facilities-based remedial measures. Only in this way can competition truly be preserved.

D. Accountability

Finally, SPI urges the Board, should any further mergers be proposed and approved, to impose conditions for true accountability. As set forth in subsection B above, railroads have made numerous representations of benefits in prior merger proceedings. Many of those service projections apparently have not been realized. There must be accountability, and not simply the reaction of the financial markets.[10] SPI urges the Board to require any merging carriers to report each category of claimed benefit on a periodic basis. The most critical category of reporting is service. Users of railroad transportation service measure service not in terms of terminal dwell time or average velocity. Rather, the critical component to users of freight transportation service is how long it takes a car to get from point of origin to destination. Accordingly, identification of key corridors, with reporting of pre-merger transit times for benchmarking purposes and reporting of post-transaction transit times for accountability is essential in order to measure whether or not a merger has a positive effect upon service to the shipper community. These measurements should be separately reported for intermodal, manifest and unitrain shipments, so that each category of service can be evaluated on its own merit.

III. Conclusion

In summary, SPI respectfully submits that rail mergers have not well served the shipping community. Nor have rail mergers served the shareholders of the carriers. SPI has substantial concern that any further consolidation will not reverse past effects, long term as well as short term, but rather will exacerbate the existing poor quality of service and reduction or outright elimination of competitive opportunities. To the extent that the Board entertains, and approves, any further merger requests, SPI respectfully submits that the Board must adopt a real-world view of competition and preserve the competition that currently exists, as well as hold the railroads accountable for the benefits claimed from consolidation.

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10 A depreciating stock price seems only to motivate railroad management to seek another merger opportunity, and thereby to perpetuate the mistakes of the past in an effort to bolster share price. The aforementioned "Open Letter" by CP, CSX, NS and UP is most telling if they are signaling that, although at least

Respectfully submitted,

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two of those carriers are still working out integration problems from their last consolidation, they would be stampeded into seeking another consolidation merely to keep up with BN and CN.

Scheduled Service Can Work

I've forgotten who said "the more things change, the more they remain the same," or "There is nothing new under the sun," but they are certainly appropriate quotations to apply to John Gallagher's article on scheduled railroads ("Reconsider This," July 12). Scheduled railroad service is not new. It has been around for years. Scheduled railroads used to provide rail service that was vastly superior to today's rail service, in spite of all the efficiencies and improved single-line service that mergers and new technology were supposed to bring.

I've enjoyed the discussion in the articles, but I take issue with the ex-railroaders who say it won't work. I am in my 57th year of working with rail transportation and I know from experience that it will work. Obviously, it won't work if railroad management believes that "car scheduling ... probably isn't worth the trouble," as the article quotes ex-Conrail railroader John Sammons as saying. Tell that to a shipper who constantly has to adjust inventories and production schedules to cope with rail deliveries that are totally unpredictable.

Years ago, the Norfolk & Western Railway slogan was "Precision Transportation" and, believe me, it was not a meaningless advertising phrase. The N&W lived up to it in the 1930s and 40s, and even into the 50s and 60s. I grew up in a company-owned mining town located on a 52-mile N&W branch line. As an avid teen-age train watcher, I could count on the morning freight train passing through town just as the 7 o'clock company whistle blew. Much later, as an N&W yard clerk in Bristol, Va.-Tenn., I would stand in the yard office window and watch the caboose on Train 88 start moving at 3:05 p.m., its scheduled departure time on its journey to Roanoke and Hagerstown.

Later, as a transportation manager for Eastman Kodak Co. at its chemicals division headquarters in Kingsport, Tenn., I had firsthand experience as a shipper with the practical results of scheduled railroading. We were producing a plastic that was used in manufacturing shoe heels, with customers located in New Jersey and New England. Instead of using truckload service directly to the customer, we would combine multiple orders into carloads and ship to Jersey City and Boston for short-haul delivery by truck. Timing was critical.

Our route to Jersey City was the so-called Alphabet Route of CC&O-St Paul, VA-N&W-Hagerstown-WM-Lurgan PA-RDG-Allentown-CNJ, a series of railroads that had coordinated their schedules to compete with the single-line route of the Pennsylvania Railroad north of Hagerstown. We got fourth morning delivery in Jersey City and fifth and sixth in Boston.

The key word in that sentence is "compete." In addition to competing with the truck lines, the separate railroads in the Alphabet Route were also competing with other railroads, or routes. In order to provide competitive service, they had to run their component connecting trains on a regular and dependable schedule, regardless of the tonnage that was available at the scheduled time of departure. That is what today's railroads are going to have to do if they provide the consistent service that shippers are pleading for. A shipper on a shortline, a branch line, or a secondary line, should be able to depend on his or her carloads leaving at an appointed time, which will be "just in time" to connect with main line trains at the junction, which, in turn, will be scheduled to connect with their counterparts on connecting lines, such as the BNSF and Norfolk Southern at Memphis, or the Union Pacific and CSX at New Orleans. But scheduled railroads will only work if all the Class 1s cooperate with coordinated schedules.

I remember when "run-through" trains were touted as the answer to improving service. They were supposed to do just what I'm talking about, but do they? If they do, why does it take 10 to 15 days or more for a bulkhead flatcar of lumber to travel from Washington state to a Rochester suburb? Why does it take almost that long to deliver a carload of corn sweeteners from Decatur, Ill., to a shortline connection in Rochester? I'm not talking about service since the June 1 takeover of Conrail by CSX and NS, which is a total mess that I hope time will cure. I'm talking about transit times in the premerger days.

So, now we come to the philosophical part of the discussion. Most railroad operating men (and women) and their management that I knew in my early days of railroading, and during most of my career with Eastman Kodak in Kingsport and Rochester, were proud of their jobs and took great pride in seeing that the trains ran on time or reasonably close to it. They knew that they had it in their power to make a satisfied customer, whose shipment made all the connections and was delivered on the day it was due, without damage. Many railroaders feel that way today, but unfortunately, they don't have much to say about it anymore, what with remote dispatching and impersonal supervision or none at all, what with the cutting of staff and the closing of offices. They've seen the switch to "wholesale" railroading, with their management concentrating on big shipper traffic moving between big city pairs, leaving the "retail" customers to the shortlines, or to no rail service at all.

I doubt that the few remaining Class 1s will inaugurate scheduled rail service anytime soon, except on some intermodal service between big city pairs and for big shippers, like UPS and the Postal Service. Some special unit trains, like the Tropicana orange juice specials, will run on a schedule, but the rank-and-file shipper will have to wait for consistent and dependable deliveries as long as Wall Street is complaining about capital expenditures and calling for more cost cuttings. I hope *Traffic World*, the NITL, CMA and other shipper groups, will keep reminding the railroads that, while they've come a long way in increasing productivity, it doesn't amount to much if they can't deliver the goods on time.

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